

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES)
OF MUHLENBERG COUNTY) CASE NO. 8825
WATER DISTRICT NO. 3)

O R D E R

On May 5, 1983, Muhlenberg County Water District No. 3 ("Muhlenberg") filed notice with the Commission proposing to increase its rates for water service rendered on and after May 25, 1983. The proposed rates would increase Muhlenberg's water revenue by \$62,313 annually, an overall increase of 30.45 percent with an increase of 24.44 percent for residential and commercial customers and an increase of 89.08 percent for the City of Sacramento. Muhlenberg stated that the proposed adjustment in rates was necessary in order to allow it to meet the costs of providing water service to its customers and to recover an increase in its cost of water from its supplier, Central City Municipal Water and Sewer System.

On May 8, 1983, the Commission entered an Order suspending the proposed rates and charges for 5 months from the effective date in order to determine the reasonableness of the proposed rates. A public hearing was held in the Commission's offices on July 6, 1983, with the City of Sacramento being the sole intervenor.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearings and investigation of Muhlenberg's proposed revenue requirements and rate design and provides rates and charges that will produce an increase in annual revenues of \$51,657.

Test Period

Muhlenberg proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period in this matter.

Revenues and Expenses

Muhlenberg had a net operating income during the test period of \$38,511. In order to reflect current operating conditions, Muhlenberg proposed several adjustments to revenues and expenses which resulted in an adjusted net operating loss of \$13,146. The Commission finds the appropriate level of adjusted operating income from water operations to be \$6,681 including interest and rental income of \$12,150.

In its analysis of Muhlenberg's operations, the Commission is of the opinion and finds that Muhlenberg's proposed adjustments are generally proper and has accepted them for rate-making purposes with the following exceptions:

Commissioner Fees

Muhlenberg proposed to increase its Commissioner fees and expenses from \$10,800 to \$12,600 annually or an increase of \$1,800, for its three commissioners, an average of \$4,200 per commissioner annually or \$350 monthly. During cross-

examination of Mr. W.A. Stirsman, Chairman of Muhlenberg, it was determined that the additional \$1,800, or \$50 per month per Commissioner, would be provided for expenses irrespective of actual costs incurred. Since documentation is not required, the Commission is of the opinion that this additional expense is neither known nor measurable and should be disallowed.

Wages and Benefits

Muhlenberg proposed to increase test period salary and wage expense by \$4,921 based on a 10 percent wage increase granted to employees on April 1, 1983, and to normalize wage adjustments incurred during the test period. The last wage increase prior to the increase granted in April of 1983 was granted in May 1982. The May 1982 increase was 9.1 percent for the manager and bookkeeper, 10 percent for the meter reader and 19.4 percent for the office clerk. In addition to wages, Muhlenberg implemented a paid pension plan at the beginning of 1983.

The Commission is of the opinion that the wage increase proposed by Muhlenberg is excessive and unreasonable and should not be allowed in total for rate-making purposes. Factors such as the financial condition of the utility, prevailing economic conditions, the type of work performed, the level of compensation necessary to retain competent

employees and fringe benefits must be considered when wage increases are evaluated. When such factors are not adequately considered in the case of a regulated utility in a non-competitive environment, excessive rates are ultimately placed upon the customers. The Consumer Price Index for urban workers ("CPI-W"), a primary measure of inflation, for the 12 months ending May, 1982, and the 12 months ending April, 1983, was 6.5 percent and 3.95 percent, respectively.

When coupled with the newly instituted paid pension plan, the level of compensation paid by Muhlenberg far exceeds the increase in the CPI-W for the last 2 years. Since September, 1982, the annual percentage increase in the CPI-W has been 5 percent or less, declining to less than 3 percent annually through the end of July, 1983. The CPI-W is frequently considered by industry in wage increases and the Commission finds it to be useful in analyzing proposed wage and salary adjustments. Therefore, the Commission is of the opinion that the maximum increase in wages from the increase granted in April, 1983, which should be passed on to Muhlenberg's customers is 5 percent. Thus, Muhlenberg's proposed wage adjustment has been reduced by \$1,992.

Accordingly, Muhlenberg proposed to adjust employer FICA taxes, state unemployment and the pension plan to reflect its adjusted level of wages and Commissioner fees by \$450, \$84, and \$2,734, respectively. In order to reflect the Commission's adjusted level of wages and Commissioner fees

for rate-making purposes, these adjustments to employee overheads were reduced to \$196, \$51, and \$2,616, respectively, a total reduction in expenses of \$405.

Computer Costs

Muhlenberg proposed to include the costs of an office computer and the necessary computer software in its operating expenses in the amount of \$2,400, which represented the depreciation of the total costs over 5 years. Muhlenberg's basic reason for using 5 years was that it was a reasonable time period to recover the capital expenditure and that, in particular, the software would probably be obsolete in that time period. However, during cross-examination Muhlenberg stated that the physical equipment would probably last longer than 5 years, but that there could be certain software and hardware changes.

It is the Commission's opinion that Muhlenberg's 5-year estimated life is based on anticipated technological changes and not the declining functionality of the equipment. Since the purpose of the computer and its software is primarily for billing, the Commission is of the opinion that this function can be provided without substantial changes in the equipment for a period greater than 5 years. Therefore, the Commission estimates the functional useful life of the computer and its software to be approximately 10 years, thus reducing depreciation expense by \$1,200.

Additionally, it was discovered during cross-examination that the billing function is currently provided

by an outside source at an annual cost of \$2,280 during the test period. Since the installation of the computer will duplicate this function, the test period level of cost should be eliminated. Thus, test period operating expenses have been reduced \$2,280.

Interest Income

During the test period, Muhlenberg had interest income of \$26,042. Because of declining interest rates subsequent to the test period, Muhlenberg proposed a reduction in interest income of \$17,711 based on an investment of \$107,899 at 8.5 percent. At July 5, 1983, Muhlenberg had total investments of \$127,899 earning an average annual rate of 8.78 percent. On Exhibit 1, Schedule 6, the difference of \$20,000 between the proposed level of investment and the actual level of investment was proposed because of reductions in other investments to provide funds for projected plant additions to be made later in 1983 to serve approximately 25 new customers. Muhlenberg did not adjust its test period revenues or expenses for the effect of these additional customers. Therefore, the Commission is of the opinion that the appropriate level of investment for rate-making purposes is the end of the test period amount of \$127,899.

The interest rate on 6-month certificates of deposit has ranged between 8 and 10 percent for the last several months with the average for the past 3 months being in excess of 9.5 percent and the average for the last 12 months being

approximately 9.45 percent. Therefore, the Commission is of the opinion that an appropriate projected rate of interest at this time is 9.5 percent, which produces projected annual interest income for Muhlenberg of \$12,150. Thus, the Commission has increased adjusted interest income by \$2,979.

Therefore, the Commission finds that Muhlenberg's adjusted test period operations are as follows:

	<u>Muhlenberg's Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$209,276	\$ -0-	\$209,276
Operating Expenses	<u>222,422</u>	<u><7,677></u>	<u>214,745</u>
Net Operating Income	\$<13,146>	7,677	\$ <5,469>
Interest Income	<u>9,171</u>	<u>2,979</u>	<u>12,150</u>
Income Available for Debt Service Coverage	<u>\$ <3,975></u>	<u>\$ 10,656</u>	<u>\$ 6,681</u>

Revenue Requirement

Muhlenberg proposed and the Commission has accepted the debt service coverage method ("DSC") to determine revenue requirements. Muhlenberg's average debt service for the next 5 years is \$48,615. The Commission finds that Muhlenberg's pro forma net operating income available for debt service coverage of \$6,681 provides a DSC of .14X, which is clearly unfair, unjust and unreasonable. The Commission is of the opinion that a DSC of approximately 1.2X is necessary to service Muhlenberg's debt requirements to insure Muhlenberg's financial stability and to provide reliable and adequate

service to Muhlenberg's customers. Therefore, Muhlenberg is authorized to increase its rates to produce additional annual revenue of \$51,657 on an annual basis ($\$48,615 \times 1.2 = \$58,338 - 6,681 = \$51,657$).

Rate Design

Muhlenberg serves the City of Sacramento under a two-step rate schedule. Muhlenberg has proposed to change its rate schedule to a single rate per 1,000 gallons. The Commission is of the opinion that the proposed rate design is fair, just, and reasonable and should, therefore, be approved.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Muhlenberg would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Muhlenberg's customers and should produce annual revenues of approximately \$256,307.


IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are the fair, just and reasonable rates to be charged by Muhlenberg for water service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Muhlenberg be and they hereby are denied.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Muhlenberg shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing sewer service.

Done at Frankfort, Kentucky, this 21st day of September, 1983.

PUBLIC SERVICE COMMISSION


Chairman

Did Not Participate
Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8825 DATED SEPTEMBER 21, 1983

The following rates are prescribed for the area served by Muhlenberg County Water District No. 3. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

RATES: Monthly

First	2,000 gallons	\$ 7.26 Minimum Bill
Next	8,000 gallons	2.42 per 1,000 gallons
Next	10,000 gallons	2.00 per 1,000 gallons
Next	30,000 gallons	1.51 per 1,000 gallons
Over	50,000 gallons	1.15 per 1,000 gallons

City of Sacramento

All Usage	\$ 1.15 per 1,000 gallons
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